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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 932

TRUST U/W OF MARY LILY (FLAGLER) BINGHAM, MESSRS. WILLIAM R. KENAN, JR., AND LAWRENCE C. HAINES, TRUSTEES, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The majority (R. 30), concurring (R. 35), and dissenting (R. 36) opinions in the Tax Court are reported at 2 T. C. 853. The opinion of the Circuit Court of Appeals (R. 41–45) is reported at 145 F. 2d 568.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on November 27, 1944. (R. 45.) The petition for a writ of certiorari was filed on February 9, 1945, and was granted March 12,

1945. (R. 47.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether judicial review of the Tax Court's determination of the issues upon the merits is precluded by the principles stated in *Dobson* v. *Commissioner*.

2. Whether legal fees and charges incurred (a) in connection with the final distribution of a testamentary trust estate and (b) in litigating an income tax deficiency assessed by the Commissioner, growing out of the prior payment of a bequest by the trustees, are deductible as "non-trade or non-business expenses" within the meaning of Section 23 (a) (2) of the Internal Revenue Code.

STATUTES AND OTHER AUTHORITIES INVOLVED

The statutes, regulations, and committee reports involved are set out in the Appendix, *infra*, pp. 30–42.

STATEMENT

The Tax Court found the following facts (R. 26–30):

At all relevant times the taxpayers were the trustees of a trust created by the will of Mary Lily (Flagler) Bingham. Their principal office was in New York, New York, and they filed their income tax return for the taxable year 1940 with

the Collector of Internal Revenue for the Second District of New York. Their books and accounts have always been kept on a cash basis and the income tax return filed by them for the taxable year was filed on the same basis. (R. 26.)

Mary Lily (Flagler) Bingham died on July 27, 1917. By her will, which was dated September 23, 1916, and probated in August, 1917, she appointed two individuals as executors and trustees and, after making a certain devise of real estate and certain specific bequests of jewelry, provided for the conveyance to the trustees of all the residue of the property, real and personal, of which she should die seized and possessed. The will provided for the payment by the trustees to various parties of at least $536,000 in cash legacies and for the delivery by the trustees to various other parties of 40,250 shares of Standard Oil Company stock. All of these beneficiaries were to receive their legacies as soon as compatible with the due administration of the estate and the carrying out of the testator's wishes with reference to the hotel and railroad properties mentioned in item ninth of the will hereinafter set out. The will further provided for the payment of $200,000 annually to a niece of the testator, Louise Clisby Wise, until she should attain the age of forty years, when she was to be paid the lump sum of $5,000,000, if compatible with the interest of the estate as determined by the trustees. The will

also provided that the trustees should pay $75,000 annually to the University of North Carolina during the continuance of the trust and at the expiration thereof should pay to the University such a sum in cash as would produce an annual income of $75,000. (R. 26–27.)

Item ninth of the will provided as follows (R. 19–20):

> All the rest and residue of my estate including all lapsed bequests or devises, shall be held for the term of twenty-one years from the date of this will by my said Trustees in trust for the maintenance and administration and development of the Florida East Coast Railway and the Florida East Coast Hotel properties (which are hereinafter called "Principal properties") and the properties held by subsidiary Companies. And to that end, my said Trustees shall have power to sell any of my said residue estate, except the stocks and bonds of said "principal properties," to invest the proceeds of such sales and the income and increments of all my said residue estate in such securities or other properties as they may think best; to use any of the said proceeds or said income or increments for the benefit of any of said principal or subsidiary properties; to make and execute any and all obligations, and all pledges and mortgages of any of my said residue estate except the stocks and bonds of the said principal properties, which may be necessary for the purposes of the maintenance,

> administration or development of the said principal or subsidiary properties; to exchange any of said properties, other than the principal properties and the stocks and bonds thereof. for any property which to them may seem desirable to be acquired for the benefit of the said principal or subsidiary properties, and continuingly to invest, sell and reinvest at such times and in such manner and in such sums and in such properties as may seem to them desirable for the purpose of carrying out the maintenance, administration and development of the said properties the primary purpose of this trust being the keeping together of the enterprise into which my beloved husband, Henry M. Flagler, put so much of his energy, ambition and life.

The will further provided that each of the trustees should receive compensation at the rate of $50,000 a year for his services, which should also cover the services which he might render as executor. (R. 28.)

At the end of twenty-one years from the date of the will the trustees were to divide the property into three equal parts for transfer to the testator's two sisters and brother in equal shares. (R. 28.)

The Commissioner's determination of a deficiency resulted from the disallowance of $210,741.93 expenses paid by the trustees in 1940 and deducted by them from gross income in their income-tax return for that year. The Commis-

sioner's reason for the disallowance of these expenses was that they were not ordinary and necessary expenses incurred in carrying on a trade or business within the meaning of Section 23 (a) of the Internal Revenue Code, now Section 23 (a) (1). By stipulation (R. 10–14) the parties agreed that all of the expenses originally disallowed by the Commissioner were ordinary and necessary expenses paid during the taxable year for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, save one item of $25,867.31 paid for legal fees and charges. (R. 28–29.) The expenses so agreed upon are as follows (R. 29):

Compensation of trustees	$141,389.86
Office salaries	34,934.30
Office supplies and expenses	2,448.97
Petty cash expenditures	1,722.89
Office rent (net)	3,419.10
Tax and financial services	498.75
Miscellaneous expenses	480.75
Total	184,874.62

Of the legal fees and charges of $25,867.31 paid by the taxpayers, $16,439.96 were for services rendered from August, 1937, to January, 1940, in contesting a deficiency of $365,687.12 in income tax asserted against the taxpayers for the year 1935. This deficiency was asserted by reason of the inclusion by the Commissioner in income of alleged gains of $1,991,316.75 resulting from the partial payment in securities of the bequest of

$5,000,000 to Louise Clisby Wise, above-mentioned. The payment was made in 1935, partly in cash and partly in securities at their then-current values. Some of the securities had been purchased by the trustees and some had been part of the estate of the decedent at her death. The Commissioner determined that, to the extent that the value of the securities purchased exceeded their cost and to the extent of the appreciation of the other securities, their distribution resulted in capital gains taxable as specified in Section 117 of the Revenue Act of 1934. It the case of *Kenan* v. *Commissioner*, 40 B. T. A. 824, the Commissioner's determination was sustained, and in 114 F. 2d 217 (C. C. A. 2d) the decision was affirmed upon appeal. (R. 29–30.)

Of the remaining legal fees and charges paid by the taxpayers, $780.85 were incurred in connection with the payment of the legacy to the University of North Carolina, described *supra*, p. 5. (R. 30.) The other $8,646.50 were paid for services rendered in respect of tax and other problems resulting from the expiration of the trust and the delivery of its assets to the legatees. (R. 30.)

The Tax Court allowed the disputed deduction (R. 35), but the Circuit Court of Appeals reversed. (R. 45.)

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SUMMARY OF ARGUMENT

I

The issues presented in this case are issues of law and not of fact. They relate to the correctness of certain general propositions which are asserted under the statute and upon which both Congressional committee reports and the Bureau of Internal Revenue in Treasury Regulations have taken positions. The court below was empowered to consider these issues upon the merits and was not bound by the Tax Court's determinations with regard to them.

If the petitioners' contention were upheld, the question of what constitute expenses incurred for the management of property held for the production of income would be left for determination in each case, without guidance other than that contained in the language of the statute itself. This is not a method of applying the statute which is administratively feasible or which was intended by Congress, as the committee reports demonstrate. Applicable Treasury Regulations cover the case, moreover; and their validity is in question. It has never been held that the Tax Court's decision of a question which involves the validity of a Treasury Regulation is one of fact. To the extent that deference is due from courts to administrative authority in determining such a question, it is owed to the Regulations and not to a decision of the Tax Court which conflicts with the

Regulations. This Court has so held in the past and it expressed the same view in *Dobson* v. *Commissioner*, 320 U. S. 489, 502. The Circuit Court of Appeals did not exceed its authority or violate the principles of the *Dobson* decision by reversing the decision of the Tax Court.

II

It was conceded in the Tax Court that the expenses here involved had no connection with the "production or collection of income" within the meaning of the statute. The question is whether these expenses were incurred for "the management, conservation, or maintenance of property held for the production of income." The rationale of Section 121 of the Revenue Act of 1942 (Appendix, *infra*, p. 30), adding the quoted words to Section 23 (a) of the Internal Revenue Code, is consistent. On the one hand the management or conduct and maintenance of income-producing property, enterprises, and activity give rise to expenditures which, with exceptions, are deductible; on the other hand, the expenses incident to consumption or other personal activity or to the transfer and devolution of property are not deductible, except as specific provision is made to the contrary.

The fees and charges connected with the final distribution of the trust estate bore no relation to the property as a source of income but had to do solely with its devolution. Their deduction would

go counter both to the words and to the rationale of the statute. The House committee report and the Treasury Regulation (Appendix, *infra,* pp. 32, 38) specifically deny the deduction of such expenses with respect to decedents' estates, and there is no adequate reason for a different conclusion with regard to trust estates.

The fees and charges incurred in contesting the income tax deficiency growing out of the payment to Louise Clisby Wise were paid to protect the trust property from liability for a tax upon the capital gain in shares of stock which had been transferred in paying the bequest to her. At the time the expenses were incurred the remaining property was ready for distribution. Consequently, as the court below found, the property was no longer being held for the production of income; and for this reason alone these expenses are not deductible. Even if the trust property be regarded as held for the production of income during the period the tax deficiency was contested, however, the expenses of the contest are not deductible. There must be a proximate relation between expenses and property in order to render the expenses deductible, as the Congressional committee reports and the Treasury Regulations all state (Appendix, *infra,* pp. 31, 37, 41).

The principle advanced by the court below, that the contested tax must affect the yield or the appreciation of the property, is more liberal than the

provision of the Regulation; but the court's principle excludes deduction of the expense of opposing the deficiency assessment in the present case. The property which appreciated in value and thereby gave rise to the tax liability asserted by the Commissioner had left the trustees' hands before the deficiency was assessed, and there was no relevant connection between it and the property which remained. In no permissible sense could the petitioners be said to be managing, conserving, or maintaining the remaining property by opposing the assessment of taxes upon past gains from other property. The lower-court decisions have on the whole been in accord with this view.

ARGUMENT

I

THIS CASE PRESENTS ISSUES OF LAW WHICH ARE SUBJECT TO REEXAMINATION UPON JUDICIAL REVIEW UNDER THE PRINCIPLES OF THE DOBSON DECISION

The petitioners err, we believe, in contending that the case involves issues of fact upon which the Tax Court's determination is final. Whatever may be the ultimate criteria for distinguishing questions of law from questions of fact for purposes of the judicial review of administrative decisions, including decisions of the Tax Court, cf. *Dobson* v. *Commissioner*, 320 U. S. 489, 501; Dickinson, *Administrative Justice and the Supremacy of Law* (1927), pp. 49–55, 312–318;

Stern, *Review of Findings of Administrators, Judges and Juries* (1944), 58 Harv. L. Rev. 70, 93–95, it is evident that issues of law and not issues of fact are presented in this case. These issues are broader than the particular facts presented. They relate to the correctness of certain general propositions which are asserted under the statute and upon which both Congressional committee reports and the Bureau of Internal Revenue in Treasury Regulations have taken positions. The court below was empowered to consider these issues upon the merits, subject to such deference as should be accorded to the legislative history and to applicable administrative determinations; and the issues are now before this Court for final decision.

The propositions advanced by the Commissioner, the validity of which is here involved, may be stated as follows: (1) That legal fees and charges incurred in distributing the corpus of a testamentary trust estate to the legatees are not expenses incurred "for the management, conservation, or maintenance of property held for the production of income" within the meaning of Section 23(a)(2) of the Internal Revenue Code as amended (Appendix, *infra*, p. 30); and (2) that expenses incurred after and just prior to the scheduled expiration of the term of a trust, in litigating an alleged tax deficiency of the trust

growing out of a payment previously made to a legatee, are not such expenses; or, more broadly, that the expense of opposing any tax deficiency affecting neither the yield nor the appreciation of non-business capital retained by the taxpayer is not such an expense. These are recurring issues in respect to the tax liability of trusts. If the issues are determined favorably to the Government, the result will be the "carving out [of] this special group of expenses * * * making them nondeductible" in future cases as well as in this case (*Textile Mills Corp.* v. *Commissioner,* 314 U. S. 326, 338); if they are determined favorably to the taxpayer, the same "special group of expenses" will have been rendered deductible. The question is, which result squares with the statute.

If the petitioners' contention were upheld in the terms in which it is made, the question of what constitute expenses incurred for the management of property held for the production of income would be left for determination in each case, without guidance other than that contained in the language of Section 23 (a) (2) of the Internal Revenue Code itself. This Court has not so held; nor is this a method of applying the statute which commends itself as administratively feasible or which was intended by Congress. The committee reports which accompanied the enactment of the statute (Appendix, *infra,* pp. 35–42) contain sub-

stantial guides to the meaning of the section in numerous of its applications—guides which, so far as they are given effect, constitute subsidiary propositions of law. As elaborated in the applicable Regulation (Treasury Regulations 103, Sec. 19.23 (a)-15, Appendix, *infra*, pp. 30–35), these guides, unless *ultra vires*[1] or legally erroneous, are controlling. *Textile Mills Corp.* v. *Commissioner, supra*, p. 337. Thus the matter is not left entirely at large, as this Court recognized in *McDonald* v. *Commissioner*, 323 U. S. 57.

It is true, of course, as this Court has stated (*Commissioner* v. *Heininger*, 320 U. S. 467, 475), that "in most instances" the relation of an expenditure to a business or, no doubt, to the management or preservation of property held for the production of income presents a question of fact, and that it is ordinarily a fact question whether a given expenditure is ordinary and necessary. It is also true, however, that such a question may become one of law because a controlling general proposition is involved. The passage from *Mc-*

[1] It would be late in the day to contend that the Treasury Department does not have authority to promulgate regulations under the revenue acts, after this Court for decades has held such regulations to be of the highest significance in determining the meaning of these acts. *Helvering* v. *Griffiths*, 318 U. S. 371, 395–397. Cf. Surrey, *The Scope and Effect of Treasury Regulations* (1940), 88 U. Pa. L. Rev. 556; Paul, *Use and Abuse of Tax Regulations in Statutory Construction* (1940), 49 Yale L. J. 660; Internal Revenue Code, Secs. 62, 3791 (26 U. S. C. Secs. 62, 3791).

Donald v. *Commissioner, supra,* which petitioners quote in their brief (pp. 15–16), holds that even then weight may attach to the determination of the Tax Court, as of course it may and as the *Dobson* opinion also stated (320 U. S. 489, 502)—not that the issue in that case was one of fact.

In the present case both the House committee report accompanying the Revenue Act of 1942, which added paragraph (2) to Section 23 (a) of the Internal Revenue Code, and the applicable Treasury Regulation (Appendix, *infra,* at pp. 38, 32) state explicitly that the expenses of administering a decedent's estate are not deductible under the new provision. The Regulation states also that expenditures incurred for resisting a proposed additional assessment of taxes, other than taxes on property held for the production of income, are not deductible. (*Infra,* p. 34.) Unless a testamentary trust is to be treated differently from a decedent's estate for this purpose, the first of these propositions applies to that portion of the claimed deductions having to do with distributions; and the second proposition applies to the remainder. Barring relevant legal considerations which require a contrary conclusion, the case is thus determined.

It is self-evident that the question whether a statutory provision shall be interpreted in ac-

cordance with a statement in its legislative history is one of law. Cf. Stern, *op. cit. supra*, p. 107. The same is true of the question of the validity of a Treasury Regulation; and in no case has it been held that the Tax Court's decision of such a question is one of fact.[2] The intention of Congress to provide for judicial review of questions involving Treasury Regulations, upon review of Tax Court decisions, seems clear from the legislative history of the present provision for such review. This provision was first enacted as Section 1003 (b) of the Revenue Act of 1926 (reenacted as Section 1141 (c) (1) of the Internal Revenue Code). It provides as follows: "Upon such review, such courts shall have power to affirm or; if the decision of the Board [Court]

[2] The recent decisions of this Court which petitioners cite upon the present point (Br. 16–17) simply illustrate the situations in which determinations of fact, rather than of law, are involved. In *Commissioner* v. *Scottish American Investment Co., Ltd.*, 323 U. S. 119, the Treasury Regulation bearing upon the issue in the case stated that the question "whether a foreign corporation has an 'office or place of business' within the United States depends upon the facts in a particular case", except that there must be "a place for the regular transaction of business" and not merely one where "casual or incidental transactions might be, or are, effected". This Court pointed out that there was "no charge here that the Tax Court failed to follow the applicable statute *or regulations*". [Italics supplied.] 323 U. S. at p. 123. *Fondren* v. *Commissioner*, No. 88, this Term, decided January 29, 1945, is illustrative of cases in which, although the question presented turns upon combinations of fact, an issue of law is involved. The Tax Court was affirmed, but the basis of its decision was thoroughly reexamined.

is not in accordance with law, to modify or to reverse the decision of the Board [Court], with or without remanding the case for a rehearing, as justice may require." The committee reports covering this section state that the reviewing courts "may consider, for example, questions as to * * * the proper interpretation and application of the statute or any regulation having the force of law * * *" (H. Rep. No. 1, 69th Cong., 1st sess., pp. 19–20 (1939–1 Cum. Bull. (Part 2) 315, 328); S. Rep. No. 52, 69th Cong., 1st sess., p. 36 (1939–1 Cum. Bull. (Part 2) 332, 359)).

To the extent that deference is due from courts to administrative authority in determining issues which are covered by Treasury Regulations, moreover, it is owed to the regulations and not to decisions of the Tax Court which conflict with them; for the Treasury in issuing regulations exercises the discretion and expertise which the revenue acts bring into play. This Court has held accordingly in the past—see, e. g., *Spreckels* v. *Commissioner,* 315 U. S. 626—and clearly expressed the same view in the *Dobson* case, in which the opinion specifically limits the principles there announced to situations in which "no statute or regulation" controls. 320 U. S. at 502; cf. also pp. 492, 506; *Welch* v. *Helvering,* 290 U. S. 111, 115; *Higgins* v. *Commissioner,* 143 F. 2d 654 (C. C. A. 1).

It has been the implicit assumption or the explicit assertion of the lower Federal courts in a number of cases that they may under some circumstances review the decisions of the Tax Court with regard to the validity of attempted expense deductions under Section 23 (a) (2) of the Internal Revenue Code, since *Dobson* v. *Commissioner* as before. *Helvering* v. *Stormfeltz*, 142 F. 2d 982 (C. C. A. 8) (Tax Court reversed); *Higgins* v. *Commissioner*, 143 F. 2d 654 (C. C. A. 1) (Tax Court affirmed); *Hord* v. *Commissioner*, 143 F. 2d 73 (C. C. A. 6) (Tax Court affirmed); *Stoddard* v. *Commissioner*, 141 F. 2d 76 (C. C. A. 2) (Tax Court affirmed).[3] See also *Bowers* v. *Lumpkin*, 140 F. 2d 927 (C. C. A. 4), certiorari denied, 322 U. S. 755). As in those cases, the issues in this case are reviewable, and the court below did not exceed its authority or violate the principles of the *Dobson* decision by reversing the decision of the Tax Court.

II

NEITHER THE LEGAL FEES AND CHARGES INCURRED IN DISTRIBUTING THE TRUST ESTATE NOR THOSE INVOLVED IN CONTESTING THE TAX DEFICIENCY WHICH RESULTED FROM THE PRIOR PAYMENT OF A LEGACY ARE DEDUCTIBLE UNDER SECTION 23 (a) (2) OF THE INTERNAL REVENUE CODE

Section 23 (a) (2) of the Internal Revenue Code as amended (Appendix, *infra*, p. 30),

[3] To the extent that *Heller* v. *Commissioner* (C. C. A. 9), decided January 27, 1945, 1945 C. C. H., vol. 4, par. 9169, may be considered at variance with these views, we submit that it was not correctly decided.

provides for the deduction of ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income. In the Tax Court proceedings the taxpayers conceded that the expenses involved had no connection with the "production or collection of income" as those words are used in the statute; and the question was narrowed to whether the expenses were paid "for the management, conservation, or maintenance of property held for the production of income." (R. 33.) The Tax Court held, two Judges dissenting, that all of the expenses in question are deductible as management expenses.

As to the expenses incurred in distributing the estate to the University of North Carolina and the residuary legatees, the Circuit Court of Appeals held that, since the distribution did not relate to the management of the property or to its conservation or maintenance, the expenses are not deductible. (R. 44.) As to the expense of contesting the tax deficiency growing out of the payment to Louise Clisby Wise, the court concluded that, since at the time of the proceedings the remaining trust property was not held for the production of income but was ready for distribution to the beneficiaries, and since the incidence of the contested tax "neither affected the yield of investment cap-

ital nor its appreciation", the "expense of contesting the taxes had no relation to the 'management, conservation or maintenance of property held for the production of income'." (R. 43–44.) We submit that the appellate court was correct on both points.

(a) *The Fees and Charges Connected with Distribution of the Estate.*

It is clearly the rationale of Section 121 of the Revenue Act of 1942 (Appendix, *infra*, p. 30), adding paragraph (2) to Section 23 (a) of the Internal Revenue Code, that the expenses which are rendered deductible by its second provision are those incident to the management, conservation, or maintenance of property which is being "held"—i. e., retained, although not necessarily without sale and reinvestment—as a source of income. Neither personal expenses on the one hand nor the expenses of distributing property to beneficiaries of the owner's or former owner's bounty on the other hand are rendered deductible by the statute.

This is made clear in the first paragraph of the House committee report accompanying the Act which deals with Section 121 (Appendix, *infra*, p. 36), in which it is said that "whether or not the expense is in connection with the taxpayers' trade or business, *if it is expended in the pursuit of income or in connection with property held for the production of income*, it is allowable." [Italics

supplied.] The report states explicitly (*infra*, p. 38) that expenses of administering a decedent's estate, including those incurred "in adjusting claims against the estate, or in distributing the remaining assets to the beneficiaries, are not deductible under this section", and these expenses are distinguished from those incurred by an executor or administrator for the production or collection of income, which are deductible. The same distinction is elaborated in the applicable Treasury Regulations (Appendix, *infra*, pp. 30–35), in which it is provided explicitly that the non-deductible expenses of administration include those incurred "in conserving the assets for ultimate distribution to the parties entitled thereto." (*Infra*, p. 32.)

The principle thus stated to be embodied in the statute forms a consistent whole. On the one hand the management or conduct and maintenance of income-producing property, enterprises, and activity give rise to expenditures which are deductible in determining net income, except as specific considerations create exceptions;[4] on the other hand, the expenses incident to consumption or other personal activity and to the transfer and devolution of the beneficial ownership of property are not deductible unless specific provision for their allowance is made by statute. Where the same individuals incur both types of expenses in

[4] Cf. *McDonald* v. *Commissioner*, 323 U. S. 57.

relation to the same property during a single taxable year, disentanglement may at times be difficult; but we submit that the court below adopted the correct bases for making the distinction in this case. The fees and charges incurred in distributing the trust property to the University of North Carolina and to the ultimate beneficiaries bore no relation to the property as a source of income but had to do solely with its devolution. Their deduction from income for the taxable year would go counter both to the words and to the rationale of the statute.

Petitioners contend (Br. 25–27) that a distinction is to be drawn between executors and administrators on the one hand and trustees on the other, pointing out that the Treasury Regulation contains a separate provision for trustees (Appendix, *infra*, p. 33) which, however, merely repeats the language of the statute. They also point out that administration expenses which are not deductible from the income of a decedent's estate under Section 23 (a) (2) of the Internal Revenue Code are deductible from the gross estate for estate tax purposes; and they reason that, since no similar deduction can be made of trustees' expenses, a substituted allowance should be made with respect to income taxes. The fact, however, that transfers of property by trustees to beneficiaries are not subjected to a capital tax similar to the estate tax can scarcely become a ground

of conferring a benefit upon trust estates. There is no statutory basis for such a benefit. In an analogous situation which might be occasioned by a gift, it would scarcely be contended that the donor would be entitled to deduct from his income tax any expenses which were incident to making the gift, even if the gift were made from a body of property which the donor was holding for the production of income; nor would the gift tax be reduced by reason of such expenditures. Cf. *Coffey* v. *Commissioner,* 1 T. C. 579, 584, 589. Clearly the petitioners are far from sustaining the burden which rests upon them of demonstrating with definiteness that there is legal provision for the deduction which they seek. *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 440; *Deputy* v. *du Pont,* 308 U. S. 488, 493; *Equitable Society* v. *Commissioner,* 321 U. S. 560, 564.

The Treasury Regulations have been consistent in characterizing expeditures of the type here in question as capital expenditures, chargeable against the corpus for tax purposes when there is a tax measured by the corpus, as in the case of the estate tax, but not deductible from income for income tax purposes. Treasury Regulations 103, Sec. 19.24–2, as amended, appendix, *infra,* p. 35. The distinction between capital expenditures and ordinary expenses has, of course, long been recognized. See, e. g., Art. 24–2, Treasury Regulations 101, 1938 Act; Art. 24–2, Treasury Regulations

94, 1936 Act; Art. 24–2, Treasury Regulations 86, 1934 Act; Art. 282, Treasury Regulations 77, 1932 Act; Art. 282, Treasury Regulations 74, 1928 Act; Art. 292, Treasury Regulations 69, 1926 Act. Cf. also *Jones' Estate* v. *Commissioner*, 127 F. 2d 231 (C. C. A. 5). The distinction applies fully to non-trade and non-business expenses under section 23 (a) (2) of the Internal Revenue Code. *Helvering* v. *Stormfeltz*, 142 F. 2d 982 (C. C. A. 8); *Bowers* v. *Lumpkin*, 140 F. 2d 927 (C. C. A. 4), certiorari denied, 322 U. S. 755; *Coughlin* v. *Commissioner*, 3 T. C. 420; but cf. *Heller* v. *Commissioner* (C. C. A. 9), decided January 27, 1945, 1945 C. C. H., vol. 4, par. 9169. Its application here leads to the conclusion that the fees and charges incurred in distributing the corpus of a trust estate are not deductible under that provision.

(b) *The Fees and Charges for Contesting the Income Tax Deficiency.*

With respect to the fees and charges of $16,439.96 which were incurred in contesting the income tax deficiency growing out of payment of the bequest of $5,000,000 to Louise Clisby Wise (*supra*, pp. 3, 6–7), different considerations come into play. These expenses were not paid in order to accomplish payment of the bequest but to protect the remainder of the trust property from liability for a tax upon the capital gain in the shares transferred. At the time the expenses were incurred the trust property was ready for distri-

bution.[5] By reason of the latter fact and because, in any event, the contested tax rested upon a past transaction and would not affect the yield or the value of invested capital, the Circuit Court of Appeals held that the cost of opposing the deficiency is not deductible.

The first and narrower ground of the decision below is sufficient in itself to determine this point of the case against the petitioners. We think the legal conclusion is correct that property which is awaiting distribution or being marshalled for distribution is held for that purpose and not for the production of any income that may accrue while it is so held. Therefore expenses which are incident to holding the property, rather than to the production of current income, are not deductible.

More broadly, however, the court below held, and the Government here contends, that even if the trust property be regarded as held for the production of income during the period the tax deficiency was contested, the expenses of the contest were not deductible. Plainly the holder of property for the production of income is not entitled to deduct the expenses of litigation unconnected with the property, merely because funds

[5] Under the terms of the testator's will the trust was to terminate 21 years from the date of the will—namely, September 23, 1937. (R. 19–20.) The fees and charges for contesting the tax deficiency were incurred during the period commencing August 27, 1937 and ending January 2, 1940. (R. 12–13.)

with which to satisfy a judgment against him might have to come from the property. In one sense, of course, opposition to such a judgment tends to conserve the property; but Section 23 (a) (2) of the Internal Revenue Code does not have reference to the expense of defending tort actions or of minimizing other unrelated obligations of one who holds property for the production of income, which may result adversely to the property. There must, rather, be a proximate relation between the litigation, with its expenses, and the property. The Congressional committee reports and the Treasury Regulations all state this requirement (see appendix, *infra*, pp. 31, 37, 41).

Applying this principle, the Regulation states with regard to taxes that

> Expenditures incurred for the purpose of preparing tax returns (except to the extent such returns relate to taxes on property held for the production of income), for the purpose of recovering taxes (other than recoveries required to be included in income), or for the purpose of resisting a proposed additional assessment of taxes (other than taxes on property held for the production of income) are not deductible expenses under this section, except that part thereof which the taxpayer clearly shows to be properly allocable to the recovery of interest required to be included in income. [Appendix, *infra*, p. 34.]

The expenses here involved are far beyond the line thus drawn, which limits the deductibility of expenditures connected with taxes to those having to do with taxes upon the property which is held for the production of income. The principle stated by the court below, that the contested tax must affect the yield or the appreciation of the property, is more liberal, since it seemingly permits deducting the expense of contesting taxes upon income from the property being held, as well as upon the property itself. If the line were drawn more widely than this, the requisite proximate relation to the property would be lost; and we submit that the Circuit Court of Appeals correctly declined to regard the fees and charges for resisting the deficiency in this case as deductible.

Here the property which appreciated in value and thereby gave rise to the tax liability asserted by the Commissioner had left the trustees' hands before the deficiency was assessed. There was no relevant connection between it and the property which remained, except that they had once been part of a single estate. This, we submit, is insufficient. In no permissible sense could the petitioners be said to be managing, conserving, or maintaining the property which remained by opposing the assessment of taxes upon past gains from other property.

The decisions have on the whole been in accord with this view. Deduction of the expenses of

contesting taxes, which have not been shown to have a proximate relation to the management or preservation of property held for the production of income, or to income from the property, has not been allowed. *Higgins* v. *Commissioner,* 143 F. 2d 654 (C. C. A. 1); *Hord* v. *Commissioner,* 143 F. 2d 73 (C. C. A. 6); *Stoddard* v. *Commissioner,* 141 F. 2d 76 (C. C. A. 2); *Willmott* v. *Commissioner,* 2 T. C. 321; *McFaddin* v. *Commissioner,* 2 T. C. 395, 410–411. Cf., however, *Manning* v. *Commissioner,* 3 T. C. 853.

Estate of Bartholomew v. *Commissioner,* 4 T. C. No. 44, upon which petitioners rely (Br. 29), presents entirely different facts and was in any event, as we believe, wrongly decided upon the relevant issue, as to which two judges of the Tax Court dissented. *Kornhauser* v. *United States,* 276 U. S. 145, holds that expenses incurred in defense of an accounting suit in order to establish the right to business income collected in the past, are deductible as ordinary and necessary business expenses; but there the litigation related to the taxpayer's right to the income in the first instance. If, moreover, expenditures to retain business income are business expenses, as the Court stated (p. 153), it does not follow that expenditures to retain the income from property which has been transferred may be regarded as ordinary and necessary expenses of managing "property held for the production or collection" of that income.

CONCLUSION

We respectfully submit that the judgment of the Circuit Court of Appeals, which was in accord with the statute and the regulations, should be affirmed.

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APRIL 1945.

APPENDIX

Revenue Act of 1942, c. 619, 56 Stat. 798, amending Internal Revenue Code, Section 23:

SEC. 121. NON-TRADE OR NON-BUSINESS DEDUCTIONS.

(a) *Deduction for Expenses.*—Section 23 (a) (relating to deduction for expenses) is amended to read as follows:

"(a) *Expenses.*—

* * * * * * *

"(2) *Non-trade or non-business expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income."

* * * * * * *

(d) *Taxable Years to which Amendments Applicable.*—The amendments made by this section shall be applicable to taxable years beginning after December 31, 1938.

* * * * * * *

(26 U. S. C., Supp. III, Sec. 23.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23 (a)-15 (as inserted by T. D. 5196, 1942-2 Cum. Bull. 96, 97-100, and amended by T. D. 5280, 1943 Cum. Bull. 1022, and T. D. 5331, 1944-4 Int. Rev. Bull. 4). *Nontrade or Nonbusiness Expenses.*—(a) *In general.*—Subject to the qualifications and limitations in Chapter 1 and par-

ticularly in section 24, as amended, an expense may be deducted under section 23 (a) (2) only upon the condition that:

(1) it has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income; and

(2) it is an ordinary and necessary expense for either or both of the purposes stated in (1) above.

The term "income" for the purpose of section 23 (a) (2) comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. * * * Expenses incurred in managing, conserving, or maintaining property held for investment may be deductible under this provision even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely to minimize a loss with respect thereto. * * *

Expenses, to be deductible under section 23 (a) (2), must be "ordinary and necessary," which presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or

maintenance of property held for the production of income.

(b) Except for the requirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business. * * *

Capital expenditures, * * * are not allowable as nontrade or nonbusiness expenses. * * *

* * * * * *

Expenditures incurred by an administrator or executor in securing the processes and orders of the court having jurisdiction over the probate of the estate, or in collecting the assets of the estate (other than income which, if and when realized, must be reported by the estate for income tax purposes), or in adjusting claims against the decedent, or in distributing the remaining assets to the beneficiaries, or in conserving the assets for ultimate distribution to the parties entitled thereto, are not deductible under this section. Ordinary and necessary expenses, however, which are paid or incurred during the taxable year by an administrator or executor for the production or collection of income which, if and when realized, must be reported by the estate for income-tax purposes, such as fees for collecting rents on property in the estate of the decedent, or for collecting interest or dividends on securities in that estate, or which are paid or incurred during the taxable year for the management, conservation, or maintenance of property in the estate of the decedent held for the produc-

tion of income, the income from which, if and when realized, must be reported by the estate for income tax purposes, such as expenditures for insurance or repairs, or expenditures of a similar nature, are deductible under this section at the option of the taxpayer notwithstanding that deductions therefor are allowable under section 812 (b) in computing the gross estate subject to the estate tax, provided the requisite statement and waiver are filed. (See section 162 (e).)

* * * * *

Reasonable amounts paid or incurred by a trustee on account of trustees' fees and other expenses which are ordinary and necessary in connection with the production or collection of trust income or with the management, conservation, or maintenance of trust property held for the production of income are deductible, notwithstanding that the trust is not engaged in a trade or business.

* * * * *

It is immaterial whether the expenses of fiduciaries are paid from the corpus of the estate or from income. Expenses derive their character not from the fund from which they are paid, but from the purposes for which they are incurred.

Expenditures incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of income which, if and when recovered, must be included in income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses. Attorneys' fees paid in a suit to quiet title to lands are not deductible; but if the suit is

also to collect accrued rents thereon, that portion of such fees is deductible which is properly allocable to the services rendered in collecting such rents. Expenditures incurred in protecting or asserting one's rights to property of a decedent as heir or legatee, or as beneficiary under a testamentary trust, are not deductible expenses. Expenditures incurred for the purpose of preparing tax returns (except to the extent such returns relate to taxes on property held for the production of income), for the purpose of recovering taxes (other than recoveries required to be included in income), or for the purpose of resisting a proposed additional assessment of taxes (other than taxes on property held for the production of income) are not deductible expenses under this section, except that part thereof which the taxpayer clearly shows to be properly allocable to the recovery of interest required to be included in income.

The deduction of an item otherwise allowable under section 23 (a) (2) will not be disallowed simply because the taxpayer also had an election under chapter 1 to treat it as a capital expenditure, rather than to deduct it as an expense. (See section 24 (a) (7), added by section 130 (a) of the Revenue Act of 1942.) Where, however, the item may properly be treated only as a capital expenditure or where it was properly so treated under an option granted in chapter 1, no deduction is allowable under this section; and this is true regardless of whether any basis adjustment is allowed under section 113.

(c) The provisions of section 23 (a) (2) are not intended in any way to disallow ex-

penses which would otherwise be allowable under section 23 (a) (1) or the regulations applicable thereto, or under any other section of the Internal Revenue Code or the regulations applicable thereto. Double deductions are not permitted. Amounts deducted under one provision of the Internal Revenue Code can not again be deducted under any other provision thereof.

SEC. 19.24–2 (as amended by T. D. 5166, 1942–2 Cum. Bull. 87). *Capital expenditures.*—Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction has been made) of property are not deductible from gross income. (See section 23 (l).) Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architects' services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities are an offset against the selling price, except that in the case of dealers in securities such commissions may be treated as an ordinary and necessary business expense. Expenses of the administration of an estate, such as court costs, attorneys' fees, and executors' commissions, are chargeable against the corpus of the estate and are not allowable deductions. * * *

H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 46, 74–76 (1942–2 Cum. Bull. 372):

6. NONTRADE OF NONBUSINESS DEDUCTIONS

The existing law allows taxpayers to deduct expenses incurred in connection with a trade or business. Due partly to the inadequacy of the statute and partly to court decisions, nontrade or nonbusiness expenses are not deductible, although nontrade or nonbusiness income is fully subject to tax. The bill corrects this inequity by allowing all of the ordinary and necessary expenses paid or incurred for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income. Thus, whether or not the expense is in connection with the taxpayers' trade or business, if it is expended in the pursuit of income or in connection with property held for the production of income, it is allowable.

* * * * * *

SECTION 118. NONTRADE OR NONBUSINESS DEDUCTIONS

This amendment allows a deduction for the ordinary and necessary expenses of an individual paid or incurred during the taxable year for the production and collection of income, or for the management, conservation, or maintenance of property held by the taxpayer for the production of income, whether or not such expenses are paid or incurred in carrying on a trade or business, and also allows a deduction for the exhaustion and wear and tear (including a reasonable amount for obsolescence) on property held for the production of income, whether or not such property is used by the taxpayer in a trade or business.

For an expense to be deductible under this section, it must have been incurred

either (1) for the production or collection of income, or (2) for the management, conservation, or maintenance of property held for the production of income. Ordinary and necessary expenses so paid or incurred are deductible under section 23 (a) (2) even though they are not paid or incurred for the production or collection of income of the taxable year or for the management, conservation, or maintenance of property held for the production of such income. The term "income" for this purpose comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years, and is not confined to recurring income but applies as well to gain from the disposition of property. Expenses incurred in managing or conserving property held for investment may be deductible under this provision even though there is no likelihood that the property will be sold at a profit or will otherwise be productive of income. The expenses, however, of carrying on a transaction which does not constitute a trade or business of the taxpayer and is not carried on for the production of income or for the management, conservation, or maintenance of property, but which is carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses.

Expenses, to be deductible under section 23 (a) (2), must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of income, or to the

management, conservation, or maintenance of property held for that purpose.

A deduction under this section is subject, except for the requirement of being incurred in connection with a trade or business, to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business. Section 24 (a) (5), as amended by this section, while continuing to disallow any amount allowable as a deduction, whether under section 23 (a) (2) or otherwise, which is allocable to one or more cases of tax-exempt income, other than interest, has the effect in addition of disallowing a deduction under section 23 (a) (2) for amounts allowable under that section which are allocable to tax-exempt interest.

Expenses incurred by an administrator or executor in the administration of the estate of a decedent, such, for example, as expenses in securing the processes and orders of the court having jurisdiction over the probate of an estate, or in adjusting claims against the estate, or in distributing the remaining assets to the beneficiaries, are not deductible under this section. Ordinary and necessary expenses, however, which are paid or incurred during the taxable year by an administrator or an executor for the production or collection of income which must be reported by the estate for income tax purposes, may be claimed as deductions under this section notwithstanding that deductions therefor are allowable under section 812 (b) in computing the gross estate subject to the estate tax. Accordingly, subsection (c) of this section amends section 162 to provide that no deduction shall be allowed under

section 23 (a) (2) in computing the net income of the estate for amounts for which there may have been or has already been allowed a deduction under section 812 (b) in computing the net estate of the decedent. The present amendment would not allow as a deduction under section 23 (a) (2) for income tax purposes any amount which is allowable under section 812 (b) as a deduction in computing the net estate of a decedent for estate tax purposes, unless the Commissioner receives a statement, filed within the time and in the manner and form prescribed by him, to the effect that the amount in question has not been claimed or allowed as a deduction under section 812 (b) and that the right to have such items allowed at any time as a deduction under section 812 (b) is waived.

Subsection (d) of this section amends section 23 (l) of the Internal Revenue Code so as to allow, in addition to the deduction allowable under the existing law, a deduction for the exhaustion, wear and tear of property held by the taxpayer for the production of income, whether or not the property in question is used in the trade or business of the taxpayer, including a reasonable allowance for obsolescence. Except for this, the new allowance is subject to the same limitations and restrictions which have been applicable under this section prior to the present amendment.

The amendments made to the Internal Revenue Code by this section are applicable to all taxable years beginning after December 31, 1938. These amendments shall also be effective as if they were a part of the Revenue Act of 1938 or any prior revenue act on the date of its enactment.

S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 87–88 (1942—2 Cum. Bull. 504):

SECTION 121. NON-TRADE OR NON-BUSINESS DEDUCTIONS

This section is the same as section 118 of the House bill, except that subsection (c) of that section has been omitted therefrom and now appears as section 163 and a clerical amendment has been made in subsection (b). The amendment made by this section allows a deduction for the ordinary and necessary expenses of an individual paid or incurred during the taxable year for the production and collection of income, or for the management, conservation, or maintenance of property held by the taxpayer for the production of income, whether or not such expenses are paid or incurred in carrying on a trade or business, and also allows a deduction for the exhaustion and wear and tear (including a reasonable amount for obsolescence) on property held for the production of income, whether or not such property is used by the taxpayer in a trade or business.

For an expense to be deductible under this section, it must have been incurred either (1) for the production or collection of income, or (2) for the management, conservation, or maintenance of property held for the production of income. Ordinary and necessary expenses so paid or incurred are deductible under section 23 (a) (2) even though they are not paid or incurred for the production or collection of income of the taxable year or for the

management, conservation, or maintenance of property held for the production of such income. The term "income" for this purpose comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years, and is not confined to recurring income but applies as well to gain from the disposition of property. Expenses incurred in managing or conserving property held for investment may be deductible under this provision even though there is no likelihood that the property will be sold at a profit or will otherwise be productive of income, and even though the property is held merely to minimize a loss with respect thereto. The expenses, however, of carrying on a transaction which does not constitute a trade or business of the taxpayer and is not carried on for the production of income or for the management, conservation, or maintenance of property, but which is carried on primarily as a sport, hobby, or recreation are not allowable as non-trade or non-business expenses.

Expenses to be deductible under section 23 (a) (2), must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of income, or to the management, conservation, or maintenance of property held for that purpose.

A deduction under this section is subject, except for the requirement of being incurred in connection with a trade or business, to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense

paid or incurred in carrying on any trade or business. Section 24 (a) (5), as amended by this section, while continuing to disallow any amount allowable as a deduction, whether under section 23 (a) (2) or otherwise, which is allocable to one or more classes of tax-exempt income, other than interest, has the effect in addition of disallowing a deduction under section 23 (a) (2) for amounts allowable under that section which are allocable to tax-exempt interest.

Subsection (c) of this section amends section 23 (l) of the Code so as to allow, in addition to the deduction allowable under the existing law, a deduction for the exhaustion, wear, and tear of property held by the taxpayer for the production of income, whether or not the property in question is used in the trade or business of the taxpayer, including a reasonable allowance for obsolescence. Except for this, the new allowance is subject to the same limitations and restrictions which have been applicable under this section prior to the present amendment.

The amendments made to the Code by this section are applicable to all taxable years beginning after December 31, 1938. These amendments shall also be effective as if they were a part of the Revenue Act of 1938 or any prior revenue act on the date of its enactment.

U. S. GOVERNMENT PRINTING OFFICE: 1945

SUPREME COURT OF THE UNITED STATES.

No. 932.—October Term, 1944.

Trust u/w of Mary Lily (Flagler) Bingham, Messrs. William R. Kenan, Jr., and Lawrence C. Haines, Trustees, Petitioners,
vs.
Commissioner of Internal Revenue.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[June 4, 1945.]

Mr. Chief Justice Stone delivered the opinion of the Court.

Petitioners are the trustees of a testamentary trust created for a term of twenty-one years under the will of Mary Lily (Flagler) Bingham. The testatrix bequeathed to the trustees the residue of her estate, including a large number of securities. The trustees were empowered in their discretion to sell any of the property held in trust (except certain securities of two companies designated as the "principal properties"), to invest and reinvest the proceeds and the income from the trust fund, and to use the proceeds and the income for the benefit of the principal properties and for the "maintenance, administration or development of the said principal or subsidiary properties." The trustees were to pay specified amounts annually to certain legatees. When the niece of the testatrix reached a certain age, she was to receive from the trust a specified amount in cash or securities. At the end of twenty-one years, the trustees were directed to pay other legacies, and to distribute the remainder of the fund in equal parts to a brother and two sisters of the testatrix.

In 1935 petitioners paid the bequest to the niece partly in securities. The Commissioner assessed a deficiency of over $365,000 for income tax upon the appreciation in value of the securities while they were in petitioners' hands. In contesting unsuccessfully this deficiency, petitioners paid out in the year 1940 approximately $16,000 in counsel fees and expenses. In that year, also, petitioners paid out about $9,000 for legal advice in connection with the payment of one of the cash legacies, and in connection with tax and other problems arising upon the expiration of the trust and relating to the final distribution of the trust fund among the three residuary legatees.

The question is whether these legal expenses, paid in 1940, are deductible from gross income in the computation of the trust's income tax, as "non-trade" or "non-business" expenses within the meaning of § 23(a)(2) of the Internal Revenue Code. That section, added by § 121 of the Revenue Act of 1942, and made applicable to tax years "beginning after December 31, 1938," authorizes the deduction of "all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income." Section 162 of the Code, so far as now relevant, makes § 23(a)(2) applicable to the income taxation of trusts.

Petitioners, in their income tax return for 1940, took deductions for the legal expenses. The Commissioner disallowed the deductions and assessed a tax deficiency, and petitioners filed the present suit in the Tax Court to set aside the assessment. That Court, after finding the facts as we have stated them, found that the trust property was held for the production of income; that all the items in question were ordinary and necessary expenses of the management of the trust property; and that the fees and expenses for contesting the income tax deficiency assessment were also for the conservation of the trust property. It therefore concluded that all were rightly deducted in calculating the taxable net income of the trust. 2 T. C. 853.

On the Government's petition for review, the Court of Appeals for the Second Circuit reversed. 145 F. 2d 568. We granted certiorari, — U. S. —, on a petition which asserted as grounds for the writ that the decision of the Court of Appeals departed from the principles laid down in *Dobson* v. *Commissioner*, 320 U. S. 489, governing review of decisions of the Tax Court, and that the decision conflicted in principle with *Commissioner* v. *Heininger*, 320 U. S. 467, and *Kornhauser* v. *United States*, 276 U. S. 145.

The Court of Appeals left undisturbed the Tax Court's findings that the questioned items were ordinary and necessary expenses for the management or conservation of the trust property, but it held that the fees for contesting the tax deficiency were nevertheless not deductible under § 23(a)(2). It thought that the expenses of contesting the income tax had nothing to do with the production of income and hence were not deductible as expenses "for the production of income" within the meaning of the statute. The court also thought that these expenses were not deductible

ecause they were paid in connection with property held by the rustees "ready for distribution", and hence not "for the produc-ion of income." Similarly it held that the fees for professional ervices rendered in connection with the payment of legacies and he distribution of the trust fund, were not expenses relating to *he management of property held* for the production of income, ince they were rendered after the trust term had expired and vhen the property was ready for distribution.

The Government makes like arguments here. In addition it irges that the expenses in connection with the distribution of the rust fund were not expenses of management of the trust prop-rty held for the production of income but only expenses relating o its devolution; and that the expenses are not deductible under § 23(a)(2) because there was no proximate relationship between he expenses when paid and the property then held in trust.

We think that these objections to the deductions fail to take proper account of the plain language of § 23(a)(2), and the pur-ose of the section as disclosed by its statutory setting and legis-ative history; and that notwithstanding the weight of the Tax Court's decision against them, they raise questions of law review-able by the Circuit Court of Appeals and by this Court.

The requirement of § 23(a)(2) that deductible expenses be "or-linary and necessary" implies that they must be reasonable in amount and must bear a reasonable and proximate relation to the management of property held for the production of income. See H. Rep. No. 2333, 77th Cong., 2d Sess., p. 75; Sen. Rep. No. 1631, 77th Cong., 2d Sess., p. 88. Ordinarily questions of reason-ableness and proximity are for the trier of fact, here the Tax Court. *Commissioner* v. *Heininger, supra,* 475; *McDonald* v. *Commis-sioner,* 323 U. S. 57, 64-65; see *Commissioner* v. *Scottish American Inv. Co.,* 323 U. S. 119. And even when they are hybrid ques-tions of "mixed law and fact", their resolution, because of the fact element involved, will usually afford little concrete guidance for future cases, and reviewing courts will set aside the decisions of the Tax Court only when they announce a rule of general applica-bility, that the facts found fall short of meeting statutory require-ments. *Dobson* v. *Commissioner, supra,* 502; *Commissioner* v. *Es-tate of Bedford,* No. 710, decided May 21, 1945; cf. Paul, "Dobson v. Commissioner," 57 Harv. Law Rev. 753, at 828-832, 836-837. But whether the applicable statutes and regulations are such as to preclude the decision which the Tax Court has rendered, is, as was recognized in *Dobson* v. *Commissioner, supra,* 492-493, a ques-

tion of law reviewable on appeal. See also *Commissioner* v. *Heininger, supra,* 475.

Here the decision of the Court of Appeals was that the expenses were not deductible because they were not for the purpose of producing income or capital gain, and because the trust property, being ready for distribution, was no longer held for the production of income. The terms of the trust, the nature of the property, and the duties of the trustees with respect to it, were all found by the Tax Court and are not challenged. The questions whether, on the facts found, the expenses in question are non-deductible, either because they were not to produce income or because they were related to the management of property which was not held for the production of income, turn in this case on the meaning of the words of § 23(a)(2), "property held for the production of income". They are therefore questions of law, decision of which is unembarrassed by any disputed question of fact or any necessity to draw an inference of fact from the basic findings. See *Commissioner* v. *Scottish American Inv. Co., supra.* They are "clear cut" questions of law, decision of which by the Tax Court does not foreclose their decision by appellate courts, as in other cases, *Dobson* v. *Commissioner, supra,* 492-493, although their decision by the Tax Court is entitled to great weight. *Dobson* v. *Commissioner, supra,* 501-502, and cases cited; cf. *Medo Photo Supply Corp.* v. *Labor Board,* 321 U. S. 678, 681-682, n. 1, and cases cited.

Since our decision in the *Dobson* case we have frequently re-examined, as matters of law, determinations by the Tax Court of the meaning of the words of a statute as applied to facts found by that court.[1] A question of law is not any the less such because the Tax Court's decision of it is right rather than wrong. Whether or not its decision is "in accordance with law" is a question which the statute, Int. Rev. Code, § 1141(c)(1), expressly makes subject to appellate review. Congress, when it thus author-

[1] See, e. g., Security Mills Co. v. Commissioner, 321 U. S. 281, 286; Douglas v. Commissioner, 322 U. S. 275; Commissioner v. Harmon, 323 U. S. 44; McDonald v. Commissioner, 323 U. S. 57; Claridge Apartments Co. v. Commissioner, 323 U. S. 141, 145; Fondren v. Commissioner, No. 88, decided January 29, 1945; Choate v. Commissioner, No. 93, decided January 29, 1945; Commissioner v. Field, No. 578, decided February 5, 1945; Webre Steib Co. v. Commissioner, No. 148, decided February 12, 1945; Commissioner v. Smith, No. 371, decided February 26, 1945; Commissioner v. Wemyss, No. 629, decided March 5, 1945; Commissioner v. Wheeler, No. 354, decided March 26, 1945; Estate of Putnam v. Commissioner, No. 534, decided March 26, 1945; Angelus Milling Co. v. Commissioner, No. 610, decided May 21, 1945; Commissioner v. Bedford, No. 710, decided May 21, 1945; Commissioner v. Disston, No. 589, decided this day.

ized review of questions of law only, was not unaware of the difficulties of such a review of the decisions of a tribunal, which decides questions both of law and of fact. But Congress did not dispense with such review.

Hence the statute does not leave the Tax Court as the final arbiter of the issue whether its own decisions of questions of law are right or wrong. That can only be ascertained upon resort to the prescribed appellate process by a consideration of the merits of the point of law involved, and by its decision at the conclusion of the process, not before it begins. The fact that the Court of Appeals below, while accepting the Tax Court's findings of fact, has nevertheless reversed its decision, would seem not to leave the question of law decided so free from doubt that the mandate of the statute could rightly be disregarded on any theory. If review were to be denied in this case, it would be difficult to say that any construction of a taxing statute by the Tax Court would be subject to appellate review.

We turn to the first ground for reversal relied on by the Court of Appeals, that the property was held for distribution, and no longer for the production of income. The fact that the trustees, in the administration of the trust, were required to invest its corpus for the production of income and to devote the income to the purposes of the trust, establishes, as the Tax Court held, that the trust property was held for the production of income during the stated term of the trust. The decisive question is whether the property ceased to be held for the production of income because, as the trust term reached its expiry date, the trustees were under a duty to distribute the property among the remaindermen.

It is true that expiration of the trust operated to change the beneficiaries entitled to receive the income of the trust property, from those entitled to the income during the term of the trust to the remaindermen. But the duty of the trustees to hold and conserve the trust property, and until distribution, to receive income from it, continued. The property did not cease to be held for the production of income because, upon the expiration of the trust and until distribution, the trustees were under an additional duty to distribute the trust fund, or because the trustees, upon distribution, were then accountable to new and different beneficiaries, the residuary legatees, both for the principal of the fund and any income accumulating after the expiry date. To exclude from the deduction privilege, expenses which the Tax Court has held to be expenses of management of the trust, on the ground that the trust fund, upon the expiration of the trust,

ceased to be "held for the production of the income" would be to disregard the Tax Court's findings of fact and the words of the statute, and would defeat its obvious purpose.

Nor is there merit in the court's conclusion that the expenses were not deductible because they were not for the production of income. Section 23(a)(2) provides for two classes of deductions, expenses "for the production . . . of income" and expenses of "management, conservation or maintenance of property held for the production of income." To read this section as requiring that expenses be paid for the production of income in order to be deductible, is to make unnecessary and to read out of the section the provision for the deduction of expenses of management of property held for the production of income.

There is no warrant for such a construction. Section 23(a)(2) is comparable and *in pari materia* with § 23(a)(1), authorizing the deduction of business or trade expenses. Such expenses need not relate directly to the production of income for the business. It is enough that the expense, if "ordinary and necessary," is directly connected with or proximately results from the conduct of the business. *Kornhauser* v. *United States*, *supra*, 152-153; *Commissioner* v. *Heininger*, *supra*, 470-471. The effect of § 23(a)(2) was to provide for a class of non-business deductions coextensive with the business deductions allowed by § 23(a)(1), except for the fact that, since they were not incurred in connection with a business, the section made it necessary that they be incurred for the production of income or in the management or conservation of property held for the production of income. *McDonald* v. *Commissioner*, *supra*, 61-62, 66; and see H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 46, 74-76; S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 87-88.

Since there is no requirement that business expenses be for the production of income, there is no reason for that requirement in the case of like expenses of managing a trust, so long as they are in connection with the management of property which is held for the production of income. Section 23(a)(2) thus treats the trust as an entity for producing income comparable to a business enterprise, and like § 23(a)(1) permits deductions of management expenses of the trust, even though the particular expense was not an expense directly producing income. It follows that all of the items of expense here in question are deductible if, as the Tax Court has held, they are expenses of management or conservation of the trust fund, whether their expenditure did or did not result in the production of income.

The Government contends that the expenses incurred in connection with the distribution of the corpus of the trust to legatees, are not deductible, because they are not expenses of managing income producing property, but expenses in connection with the devolution of the property. If the suggestion is correct, it would follow that expenses incurred in distributing the income of the trust to the income beneficiaries are likewise not deductible, since the distribution of income is also a devolution of trust property. But the duties of the trustees were not only to hold the property for the production of income and to collect the income, but also, in administering the trust, to distribute the income and the principal so held from time to time, and the remainder of the principal at the expiration of the trust. Performance of each of these duties is an integral part of carrying out the trust enterprise. Accordingly, as the Tax Court held, the costs of distribution here were quite as much expenses of a function of "management" of the trust property as were expenses incurred in producing the trust income; and if "ordinary and necessary," they were deductible.

In support of its contention, the Government relies upon a part of the House Committee Report, accompanying the bill which became the Revenue Act of 1942, see H. Rep. No. 2333, 77th Cong., 2d Sess., p. 75, and upon Treas. Regs. 103, § 19.23(a)-15, neither of which was mentioned by the Court of Appeals. They state that an administrator or executor may not deduct expenses incurred in the administration of the estate of a decedent, including those of distributing assets to the beneficiaries. It is argued that by analogy like expenses of trustees should not be deductible. But it is to be noted that there is no such statement in the Report or Regulations as to the distribution expenses of trustees. On the contrary, the Regulations, § 19.23(a)-15, in dealing specifically with expenses of trustees, provides only that their expenses of management and conservation of the trust property held for the production of income are deductible. And the references in the Report to the non-deductibility of expenses of administrators and executors were in explanation of the Congressional purpose to prevent the specified administration expenses from being deductible both for income and estate taxation. To accomplish that purpose the Report recommended an amendment, which became § 161(a) of the Revenue Act of 1942, adding § 162(e) to the Internal Revenue Code. Section 162(e) provides, with an immaterial exception, that "amounts allowable under § 812(b) as a deduction in computing the net estate of a decedent shall not be

allowed as a deduction under § 23." Here, as the Tax Court found, there is no possibility of such a double deduction, since the expenses were not deductible under the decedent's estate tax return.

What we have said applies with equal force to the expenses of contesting the tax deficiency. Section 23(a)(2) does not restrict deductions to those litigation expenses which alone produce income. On the contrary, by its terms and in analogy with the rule under § 23(a)(1), the business expense section, the trust, a taxable entity like a business, may deduct litigation expenses when they are directly connected with or proximately result from the enterprise—the management of property held for production of income. *Kornhauser* v. *United States, supra,* 152-153; *Commissioner* v. *Heininger, supra,* 470-471. The Tax Court could find as a matter of fact, as it did, that the expenses of contesting the income taxes were a proximate result of the holding of the property for income. And we cannot say, as a matter of law, that such expenses are any less deductible than expenses of suits to recover income. Cf. *Commissioner* v. *Heininger, supra.*

The Government relies on Treas. Regs. 103, § 19.23(a)-15, which provide that "expenditures incurred . . . for the purpose of recovering taxes (other than recoveries required to be included in income), or for the purpose of resisting a proposed additional assessment of taxes (other than taxes on property held for the production of income) are not deductible expenses under this section [§ 23(a)(2) of the Code], except that part thereof which the taxpayer clearly shows to be properly allocable to the recovery of interest required to be included in income." So far as this regulation purports to deny deduction of litigation expense unless it is to produce income, it is not in conformity to the statute, for the reasons already stated, or with the Regulation already mentioned, which provides that in addition to expenses for the production or collection of trust income, expenses of management or conservation of trust property held for the production of income are also deductible. To that extent and to the extent that it departs from the rule of *Kornhauser* v. *United States, supra,* it conflicts with the meaning and purpose of § 23(a)(2), and so is unauthorized. *Helvering* v. *Reynolds Tobacco Co.,* 306 U. S. 110.

We find no error of law in the judgment of the Tax Court. Its judgment will be affirmed and that of the Court of Appeals reversed.

Reversed.

SUPREME COURT OF THE UNITED STATES.

No. 932.—October Term, 1944.

Trust u/w of Mary Lily (Flagler) Bingham, William R. Kenan, Jr., and Lawrence C. Haines, Trustees, Petitioner, *vs.* Commissioner of Internal Revenue.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[June 4, 1945.]

Mr. Justice Frankfurter, concurring.

This is one of those cases in which the ground of the decision is more important than the decision itself, except to the parties. And so, while I concur in the result, I feel bound to say that I think the manner in which it is reached is calculated to increase the already ample difficulties in judicial review of Tax Court determinations. The course of our decisions since *Dobson* v. *Commissioner*, 320 U. S. 489, calls for clarification and avoidance of further confusion.

In *Dobson* v. *Commissioner, supra*, this Court elaborately considered the special function of the Tax Court and the very limited functions of the Circuit Courts of Appeals and of this Court in reviewing the Tax Court. The unanimous opinion in the *Dobson* case was surely a case of much ado about nothing, if it did not emphasize the vast range of questions as to which the Tax Court should have the final say. In making the *Dobson* pronouncement, the Court was not unaware that "questions of fact" and "questions of law" were legal concepts around which dialectic conflicts have been fought time out of mind. The *Dobson* opinion took for granted that they are useful instruments of thought even though not amenable to fixed connotations. The terms are unmanageable and too confusing if it be assumed that unless they have invariant meaning, that is, unless they serve the same purpose for every legal problem in which they are invoked, they can serve no purpose for any problem. The contribution of the *Dobson* case, one had a right to believe, was the restriction of reviewable "questions of law" in tax litigation to issues appropriate for review in

relation to the machinery which Congress has designed for such litigation. The *Dobson* case eschewed sterile attempts at differentiation between "fact" and "law" in the abstract. Instead, it found significance in the scheme devised by Congress for adjudicating tax controversies whereby Congress had, in the main, centralized in the Tax Court review of tax determinations by the Treasury and had made the decisions of the Tax Court final unless they were "not in accordance with law", 44 Stat. 9, 110, 26 U. S. C. § 1141(c)(1), with the result that, as a practical matter, only a small percentage of Tax Court decisions gets into the Circuit Courts of Appeals, and a still smaller percentage reaches this Court.[1] Therefore, the decisions of the Circuit Courts of Appeals, and even more so of this Court, are bound to be more or less episodic and dependent upon contingencies that cannot give these appellate courts that feel of the expert which is so important for wise construction of such interrelated and complicated enactments as those which constitute our revenue laws. These factors, so decisive in the stream of tax litigation, weigh heavily in apportioning functions between the Tax Court and the courts reviewing the Tax Court. Accordingly, the vital guidance of the *Dobson* opinion was that a decision of the Tax Court should stand unless it involves "a clear-cut mistake of law", 320 U. S. 489, 502. Considerations that may properly govern what are to be deemed questions of fact and questions of law as between judge and jury, or considerations relevant to the drawing of a line between questions of fact and questions of law on appeal from a court of first instance sitting without a jury, or in determining what is a foreclosed question of fact in cases coming to this Court from State courts on claims of unconstitutionality, may be quite misleading when a decision of the Tax Court is challenged in the various Circuit Courts of Appeals or here as "not in accordance with law".

Certainly, all disputed questions regarding events and circumstances—the raw materials, as it were, of situations which give rise to tax controversies—are for the Tax Court to settle and defi-

[1] As a matter of historic survival, some tax litigation still reaches district courts throughout the country. To that extent there is a qualification upon the centralization of review in the Tax Court of Treasury determinations. But the overwhelming volume of tax litigation goes to the Tax Court. The ratio is about 6 to 1. The fact that the district courts continue to have vestigial jurisdiction may call for a scientific revamping of jurisdiction in tax cases. It does not counsel against giving the fullest efficacy to Tax Court decisions consonant with its special responsibility. See Griswold, The need for a Court of Tax Appeals (1944) 57 Harv. L. Rev. 1153; Miller, Can Tax Appeals be Centralized? (1945) 23 Taxes 303.

nitively so. Secondly, there are questions that do not involve disputes as to what really happened—as, for instance, what expenses were incurred or what distribution of assets was made—but instead turn on the meaning of what happened as a matter of business practice or business relevance. Here we are in the domain of financial and business interpretation in relation to taxation as to which the Tax Court presumably is as well informed by experience as are the appellate judges and certainly more frequently enlightened by the volume and range of its litigation. Such issues bring us treacherously near to what abstractly are usually characterized as questions of law, whether the question of division of labor in a litigation is between judges and lay juries, or between judges of first instance and of appellate courts when there is no difference of specialized experience between the two classes of judges. Thus, the construction of documents has for historic reasons been deemed to be a question of law in the sense that the meaning is to be given by judges and not by laymen. But this crude division between what is "law" and what is "fact" is not relevant to the proper demarcation of functions as between the Tax Court and the reviewing courts. To hold that the Circuit Courts of Appeals, and eventually this Court, must make an independent examination of the meaning of every word of tax legislation, no matter whether the words express accounting, business or other conceptions peculiarly within the special competence of the Tax Court, is to sacrifice the effectiveness of the judicial scheme, designed by Congress especially for tax litigation to an abstract notion of "law" derived from the merely historic function of courts generally to construe documents, including legislation. More than that. If the appellate courts must make an independent examination of the meaning of every word in tax legislation, on the assumption that the construction of legislative language is necessarily for the appellate courts, how can they reasonably refuse to consider claims that the words have been misapplied in the circumstances of a particular case? Meaning derives vitality from application. Meaning is easily thwarted or distorted by misapplication. If the appellate courts are charged with the duty of giving meaning to words because they are contained in tax legislation, they equally cannot escape the duty of examining independently whether a proper application has been given by the Tax Court.

The specialized equipment of the Tax Court and the trained instinct that comes from its experience ought to leave with the Tax Court the final say also as to matters which involve construction of legal documents and the application of legislation even though the process may be expressed in general propositions, so long as the Tax Court has not committed what was characterized in the *Dobson* case as a "clear-cut mistake of law".

That serves as a guide for judgment even though no inclusive definition or catalogue is essayed. The Tax Court of course must conform to the procedural requirements which the Constitution and the laws of Congress command. Likewise, in applying the provisions of the revenue laws, the Tax Court must keep within what may broadly be called the outward limits of categories and classifications expressing legislative policy. Congress has invested the Tax Court with primary—and largely with ultimate—authority for redetermining deficiencies. It is a tribunal to which mastery in tax matters must be attributed. The authority which Congress has thus given the Tax Court involves the determination of what really happened in a situation and what it means in the taxing world. In order to redetermine deficiencies the Tax Court must apply technical legal principles. The interpretation of tax statutes and their application to particular circumstances are all matters peculiarly within the competence of the Tax Court. On the other hand, constitutional adjudication, determination of local law questions and common law rules of property, such as the meaning of a "general power of appointment" or the application of the rule against perpetuities, are outside the special province of the Tax Court. See Paul, *Dobson* v. *Commissioner: the Strange Ways of Law and Fact* (1944) 57 Harv. L. Rev. 753, 847-48. Congress did not authorize review of all legal questions upon which the Tax Court passed. It merely allowed modification or reversal if the decision of the Tax Court is "not in accordance with law". But if a statute upon which the Tax Court unmistakably has to pass allows the Tax Court's application of the law to the situation before it as a reasonable one—if the situation could, without violence to language, be brought within the terms under which the Tax Court placed it or be kept out of the terms from which that Court kept it—the Tax Court cannot in reason be said to have acted "not in accordance with law". In short, there was no "clear-cut mistake of law" but a fair administration of it.

If these considerations are to prevail, the sole question before a Circuit Court of Appeals is whether the decision by the Tax Court presents a "clear-cut mistake of law". There should be an end of the matter once it is admitted that the application made by the Tax Court was an allowable one. If a question becomes a reviewable question in tax cases because, abstractly considered, it may be cast into a "pure question of law", it would require no great dialectical skill to throw most questions which are appealed from the Tax Court into questions of law independently reviewable by the Circuit Courts of Appeals. The road would be open to a new insistence for increased tax reviews by this Court on *certiorari*. The intention of the *Dobson* case was precisely otherwise. It was to centralize responsibility in the Tax Court, to minimize isolated intrusions by the Circuit Courts of Appeals into the technical complexities of tax determinations except when the Tax Court has clearly transcended its specialized competence, and to discourage resort to this Court in tax cases except where conflict among the circuits or constitutional questions or a "clear-cut mistake of law" of real importance may call for our intervention.

Let us apply these governing considerations to the case in hand. The trustees here paid, as expenses in connection with the trust, certain legal fees, and these charges they deducted from the gross trust income for 1940. The Commissioner disallowed these deductions. The legal services concerned (1) litigation in which the trustees unsuccessfully contested a deficiency claim based on taxable gain to the estate, (2) payment of a legacy, and (3) problems arising from the expiration of the trust and the disposition of its assets. The sole question before the Tax Court was whether these fees and charges were deductible as expenses incurred "for the management, conservation, or maintenance of property held for the production of income" under § 121(a) of the Revenue Act of 1942, 56 Stat. 798, 819.

Whether these payments constituted expenses "for the management . . . of property held for the production of income," may as fairly be said to be a question of fact, namely, the purpose which these payments served with relation to property held for the production of income, as it could be said that they involve a proper construction of what the statute means by "management" of such property. The truth of the matter is that the problem involves a judgment regarding the interplay of both questions, namely, what

relation do these payments have to what may properly be deemed the managerial duties of trustees. It is possible to transform every so-called question of fact concerning the propriety of expenses incurred by trustees into a generalized inquiry as to what the duties of a trustee are and, therefore, whether a particular activity satisfied the conception of management which trusteeship devolves upon a trustee. Such a way of dealing with these problems inevitably leads to casuistries which are to be avoided by a fair distribution of functions between the Tax Court and the reviewing courts. The fact that this problem may be cast in the form of intellectually disinterested abstractions goes a long way to prove that its solution should be left with the Tax Court.

If the decision by the Tax Court may fairly be deemed to have been restricted to the facts of this case, as it may, it certainly would be an issue of "fact". But even assuming that the "issues are broader than the particular facts presented" by this case, the Tax Court's decision is not deprived of finality. Yet an assumption to the contrary is at the core of the Government's argument. Simply because the correctness of "certain general propositions" is involved does not make the position taken by the Tax Court a question of law. The real question is: What is the nature of the issue upon which the Tax Court has pronounced? If the issue presents a difficulty which it is peculiarly within the competence of the Tax Court to resolve and that court has given a fair answer, every consideration which led to the pronouncement in the *Dobson* case should preclude independent reexamination of the Tax Court's disposition. Regardless of what the question may be termed for purposes of review, the Tax Court's determination should be accorded finality. That the Tax Court has expressed an allowable opinion as to the meaning and application of a tax provision, here §121 (a) of the 1942 Revenue Act, should suffice to reinstate its decision, without opening the sluices to independent review by the Circuit Courts of Appeals and this Court of multitudinous tax questions. Such is the principle or rule of judicial administration which should guide review of Tax Court determinations.

Mr. Justice ROBERTS and Mr. Justice JACKSON join in this concurring opinion.